

# AcSB Publicly Accountable Enterprises Strategy

## AcSB Implementation Plan for Incorporating IFRSs into Canadian GAAP

### Progress Review – Final Report, February 2008

**The AcSB's decision regarding the date of adoption of IFRSs for Canadian publicly-accountable enterprises will be made after consultation with the AcSOC, no later than March 31, 2008. This report is current as of January 23, 2008. The AcSB continues to monitor developments for anything that might cast significant doubt on the continued feasibility of the planned changeover date.**

#### Introduction

The Accounting Standards Board's (AcSB) implementation plan for adoption of International Financial Reporting Standards (IFRSs) for Canadian publicly accountable enterprises stated that the plan would include a progress review to identify and assess any new information or new issues that would affect the AcSB's implementation of IFRSs for such enterprises. Also, the AcSB announced that it would confirm (or vary), no later than March 31, 2008, the expected IFRS changeover date of January 1, 2011.

In October 2007, a preliminary report on the AcSB's progress review was discussed with the Accounting Standards Oversight Council (AcSOC). This document comprises the final report. It builds on the preliminary report, taking into account additional information gathered since that time. At its February meeting, the AcSOC will be asked to provide advice on any additional matters that the AcSB should take into account before finalizing the changeover date.

As with the preliminary report, this report evaluates three main considerations:

- Is sufficient progress being made in Canada in establishing the infrastructure for IFRS implementation?
- Were there any significant difficulties encountered in the initial adoption or ongoing application of IFRSs in the European Union (EU), Australia and other countries that the AcSB should consider in determining the timing for implementing the strategy for publicly accountable enterprises?
- Does the International Accounting Standards Board (IASB) continue to develop high-quality standards that are accepted as contributing to the improved functioning of global capital markets?

## Overall view

The overall message heard by the AcSB is that, although constituents believe that the changeover will be challenging, the AcSB should set the changeover date now. Constituents are ready to get on with implementation, provided the changeover date is certain. Indeed, more people seem interested in the possibility of a voluntary early adoption than in deferring the mandatory changeover date. The common view is that it is time to “get on with it.”

As of the date of this report, the AcSB thinks that the changeover date should be confirmed for years beginning on or after January 1, 2011.

## Is sufficient progress being made in Canada in establishing the infrastructure for IFRS implementation?

The AcSB Chair and staff have consulted with Canadian securities and financial institutions regulators, financial analysts, major industry groups, financial statement preparers, academics, accountancy bodies, valuation professionals and the AcSB’s IFRS Advisory Committee. Also, AcSB staff has conducted roundtable discussions in Calgary, Halifax, Montreal, Toronto and Vancouver. The roundtables included representatives from many of the former groups, as well as representatives from smaller publicly accountable enterprises, accounting firms and other interested parties in Canada. In addition, three groups made presentations to the AcSOC at its October 2007 meeting.<sup>1</sup>

The consultations highlighted a number of challenges to be faced in preparing for the changeover, including the following:

- *Education, training and resources* — The challenge with education and training is finding sufficient skilled resources to support the changeover. There seems to be an “expectation gap” on this issue. Many people seem to think that the universities and professional accounting bodies should produce students proficient in IFRSs to help with the changeover. The reality is that newly qualified accountants will be no more knowledgeable about IFRSs than they are about Canadian GAAP today, having only an entry-level knowledge. Educators are actively developing training materials and updating textbooks and course curricula to reflect the change, even though it will take some time for the effects of these changes to be felt, and the process is somewhat slower in French. Training courses are becoming more readily available for already qualified accountants. Each of the three largest professional accounting organizations in Canada, as well as the major accounting firms, are well advanced with continuing professional education programmes about IFRSs and are making appropriate updates to their professional qualification requirements and processes. The demand for more in-depth and industry-focused training is growing, and evidence suggests that the supply is growing to meet that demand. This is where the focus must be in the future, as enterprises determine how IFRSs will affect their particular activities. Establishing the changeover date will help to increase the focus on these activities because it is

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<sup>1</sup> Representatives from the Canadian Bankers’ Association, the Committee on Corporate Reporting of Financial Executives International – Canada, and the Canadian oil and gas industry.

inefficient and less effective to undertake in-depth education too far in advance of when the knowledge gained is to be put into effect. Canadian constituents seem well positioned in this regard relative to the equivalent stage of preparation in other countries prior to their adoption of IFRSs. Analysts note that it is premature to engage in widespread training for them much before the changeover date, as they deal with historical financial reports and many of them will not be dealing with IFRS financial statements for the next few years.

- *Clarity of regulatory policies* — Constituents are seeking clarity on the questions of early adoption of IFRSs and continued use of US GAAP in Canada, as well as the expected transitional disclosures to help financial statement users understand the effects of the adoption of IFRSs. Decisions about these items are largely in the hands of the Canadian Securities Administrators (CSA), with pronouncements expected from them during 2008. The AcSB Chair and staff are communicating with CSA staff regularly on these matters and have been assured that the CSA will address these questions in the near future.
- *Resources devoted to other activities* — Some people have suggested that it will be a challenge to devote resources to the changeover, including those for necessary systems changes, while resources are needed also for other major projects, such as certification of disclosures in issuers' annual and interim filings and adoption of Basel II capital requirements. Whatever date is set for the changeover, it seems likely that there will be other business challenges to be faced in the same time period. However, it is not clear that any delay in the changeover date to allow for additional time would do anything other than delay the time at which people start to focus on the issues to be addressed. Regulators are aware of these concerns, and the AcSB expects other regulatory requirements will not be an impediment to achieving a smooth changeover to IFRSs for years beginning on or after January 1, 2011.
- *Adoption in an environment of certification* — Adoption of IFRSs in an environment that also requires certification of disclosures in issuers' annual and interim filings will be a particular challenge for Canadian entities compared to those in many other jurisdictions. However, it does not seem to warrant a delay in the changeover date.
- *Comparative amounts required by the US Securities and Exchange Commission (SEC)* — SEC registrants desired certainty as to whether an entity will need to provide two years of comparative figures to meet SEC filing requirements. The SEC has dealt with this question in recent rule-making, requiring only one year of comparative information in the first year that an entity adopts IFRSs as issued by the IASB.
- *Industry-specific technical concerns* — Some industries are identifying technical concerns. In particular, oil and gas companies have expressed concerns over the extent to which the current full cost accounting method used by most oil and gas companies in Canada is inconsistent with IFRSs. The oil and gas industry has organized itself to address the issues around full cost oil and gas accounting, and AcSB staff is working with an industry group to raise issues with the IASB. The AcSB and its staff think that this kind of effort is a model of what others should consider undertaking. Banks, investment funds and entities with rate-regulated

operations have also expressed concerns about the application of IFRSs to those businesses. People in these and other industries are working together, with support from the AcSB Chair and staff, to fully evaluate their concerns and what might be done to alleviate them, as well as to gain clarity as to how the changeover will affect them. Some of these concerns relate to the transition to IFRSs, and the AcSB is gathering information from constituents as to the need for any modifications to IFRS 1, *First-time Adoption of International Financial Reporting Standards*. In March 2008, the AcSB expects to present to the IASB, an analysis of any issues requiring changes to that standard, in order that the IASB has time to evaluate the issues and complete due process for any changes that it is prepared to make to IFRS 1.

- *Dual change in standards:* — Some people have noted possible challenges associated with standards that will require changes in accounting policies on adoption of IFRSs in 2011 and might shortly thereafter require a change in a different direction as the IASB changes an IFRS.<sup>2</sup> The AcSB acknowledges that there might be very few instances in which changes in different directions might become necessary in a relatively short time period. However, the AcSB also notes that, in evaluating the IASB work programme, instances of such dual changes are less likely to be significant with a changeover date of January 1, 2011 than they are with a later changeover date. In addition, the AcSB notes that there are likely to be significant benefits from a full changeover to IFRS at one date, rather than deferring the adoption of particular standards. These benefits include the ability to use IFRS 1 to help with the transition to IFRSs, the ability to access US capital markets without reconciliation to US GAAP, and the added complexity of modifying Canadian GAAP to leave out particular requirements and retain an alternative compatible with the rest of the body of IFRSs in the meantime. Furthermore, any significant change to IFRSs shortly after the changeover date is likely to be known by the changeover date, thus enabling planning by Canadian enterprises to minimize the effects of a dual change, including possible early adoption of the new IFRS requirements.
- *Which entities will be required to changeover to IFRSs?* — Some desire greater certainty as to exactly which entities will be required to adopt IFRSs — that is, they desire a clear definition of “publicly accountable enterprise.” The AcSB thinks that for the vast number of entities that will be required to adopt IFRSs — all listed companies and all banks, credit unions, investment funds, and the like — it is already clear that they will be required to do so. The AcSB expects to make its proposed position clearer when it issues its “omnibus” exposure draft of IFRSs, expected in March or April 2008. The AcSB thinks that this will continue to provide plenty of time for enterprises to prepare for IFRS adoption.
- *Tax considerations* — Enquiries have been made frequently regarding any potential tax effects of the changeover and the readiness of the Canada Revenue Agency

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<sup>2</sup> It is difficult to predict with any certainty which subjects are likely to cause the greatest challenges in this regard, but the most likely two topics are “derecognition of financial assets” and “consolidations,” each of which is presently scheduled for new IFRS requirements within a year or so of the projected Canadian changeover to IFRSs. Our experience is that topics on the IASB work programme take longer to complete, rather than being completed sooner than scheduled, so there is no certainty that these standards will change in the currently projected timeframe.

(CRA) and other taxation authorities to deal with such changes. The AcSB Chair and staff have had several discussions with representatives of the federal Department of Finance and the CRA, as well as senior tax practitioners. The determination of taxable income is not directly linked to GAAP financial statements.

- *Canadian due process and bilingualism* — The development of protocols to maintain due process when adopting IFRSs into Canadian GAAP, including maintaining the bilingualism policy, is well advanced.

The AcSB considers that none of these challenges is unexpected. They are not insurmountable in the time available, nor do they suggest the need for a delay of the changeover date.

The AcSB has paid particular attention to the circumstances of smaller enterprises, seeking out discussions with their representatives and their accounting firms. The expectation is that smaller enterprises will tend to start later and try to take advantage of the experiences of those that started earlier. Smaller enterprises tend to be simpler businesses in which fewer issues are expected to arise, thus making the changeover less challenging. At the same time, the resource challenge is likely to be proportionately greater for such enterprises, and accounting firms report greater challenges with educating them about the coming changes and helping them to prepare. However, the overall message has again been to “get on with it”— delay will not make the changeover any easier for smaller enterprises.

Surveys of awareness and preparedness for adoption of IFRSs suggest that individuals who need to be aware of the changeover to IFRSs generally are aware, and some have commenced detailed planning. In general, the extent of planning is greater the larger the enterprise. This is not surprising to the AcSB at this stage of transition. Once the AcSB issues its “omnibus” exposure draft of IFRSs and the AcSB confirms the changeover date, more targeted action by companies is expected.

**Were there any significant difficulties encountered in the initial adoption or ongoing application of IFRSs in the European Union, Australia, and other countries that the AcSB should consider in determining the timing for implementing the strategy for publicly accountable enterprises?**

AcSB staff has reviewed studies of the adoption of IFRSs in other countries, as well as general business media reports published during the past two years. Also, the AcSB Chair and staff have met with other national standard setters, securities regulators and representatives of major accounting firms to enquire as to their experiences with adoption and application of IFRSs.

In general, IFRS adoption in other countries seems to have gone smoothly. In particular, few, if any, issues seem to have arisen in the second year of reporting. This suggests that first-year adoption was sound.

Matters the AcSB and constituents might take into account in learning from the experiences of others include the following:

- IFRSs as promulgated by the IASB are preferable to any modified versions. Modifications can cause difficulties for cross-border consistency and analysis, as well as precluding the use of IFRS 1, which allows for significant transitional relief in the first year of full adoption of IFRSs. Australia’s experience with initially eliminating choices in IFRSs and modifying disclosures, but subsequently reversing those decisions, is instructive in that regard. Challenges with respect to EU non-endorsement of certain parts of IFRSs also highlight difficulties if “full IFRSs” are not adopted. There have been increasing calls in recent months not to modify IFRSs as promulgated by the IASB. This is the route that the AcSB intends to follow.
- Disclosure considerations were often left to the end of the initial implementation process. The result was that information gathering was a challenge and many financial statement disclosures were of the “boilerplate” variety. IFRSs require extensive disclosures, in part because of the principle-based nature of the standards, and hence the need to explain accounting policy choices made. Also, IFRS 1 requires additional disclosures in the year of first-time adoption. Because of the often last minute focus on disclosures in the first year of adoption, experience indicates that disclosures improved and became more focused in the second year of IFRS application.
- Some CFOs in Europe and elsewhere expressed concern that adoption of IFRSs was costly and made it more difficult for them to explain their financial results. The costs to convert accounting systems can be extensive, and the benefits (including reduced costs of capital) are often harder to identify and do not arise until later. Communication by enterprises about the effect on financial reporting of the transition to IFRSs has been beneficial in aiding understanding by users of financial statements. This suggests that companies need to pay attention to management discussion and analysis (which is not provided as widely in other jurisdictions as in Canada) and other supplementary disclosures as the vehicle for conveying their perspectives. It should also be noted that many European countries were faced with more extensive change than is expected in Canada, as a result of a greater difference between IFRSs and pre-existing standards. For example, many European companies adopted standards for the recognition and measurement of financial instruments for the first time on changeover to IFRSs — the vast majority of those standards have already been adopted in Canada.
- A comprehensive retraining programme is an important part of preparation.
- Industry groups can work together effectively to resolve common issues.
- The transitional challenge is proportionately greater for smaller listed companies because of their relative lack of resources.
- Active engagement with the IASB’s International Financial Reporting Interpretations Committee (IFRIC) to resolve interpretation matters is important, rather than creating local interpretations. In this regard, AcSB staff has established a group to review existing Canadian interpretations to identify any that seems to remain necessary on moving to IFRSs. Such interpretive issues will be referred to the IFRIC as soon as possible.

- The time to convert IFRSs into local law or to translate into local languages needs to be taken into account. Copyright issues also need to be resolved early. The IASB has recently instituted a one year delay between publication and the effective date of any significant new standard. Copyright agreements and translation arrangements have been negotiated with the IASB to permit the use of IFRSs in Canada.
- A clear and uniform statement by preparers and auditors that financial statements have been prepared in accordance with IFRSs is desired by securities regulators. It is acceptable to refer also to conformity with local requirements, such as Canadian generally accepted accounting principles (GAAP).
- Analysts had little difficulty with the changeover, with no general loss of confidence in financial reporting at the changeover date. The majority of financial analysts surveyed, or expressing a view, in the EU and Australia have been supportive of the adoption of IFRSs in those countries.

The AcSB and Canadian constituents can continue to learn from the experiences of others with a view to enhancing the Canadian implementation experience. While challenges were identified, and Canadian constituents can learn from those challenges, the capital markets in the EU, Australia and elsewhere experienced no discernible disruption from the changeover to IFRSs.

#### Does the IASB continue to develop high-quality standards that are accepted as contributing to the improved functioning of global capital markets?

AcSB staff has completed its review of commentaries published during the last 24 months about the quality of IFRSs in the world-wide media, professional journals and academic papers. Also, the staff has considered whether IFRSs are affected adversely by undue political or special interests, and evaluated the IASB/FASB convergence activities and the oversight role of the International Accounting Standards Committee Foundation Trustees.

Since the AcSB approved its strategy in 2006, Japan, India, China, Brazil, South Korea and Israel, among other major economies, have adopted or agreed to adopt IFRSs. According to Deloitte, there are now over 100 countries that use, or are in the process of adopting, IFRSs as their basis for financial reporting. In November 2007, the SEC announced its decision to accept financial statements prepared in accordance with IFRSs as issued by the IASB in filings by foreign enterprises raising capital in the US, without reconciliation to US GAAP. The SEC is also seriously considering the possibility of greater use of IFRSs by US companies. The AcSB Chair took part in roundtable discussions on the latter subject in December 2007. The FASB Chair, and others, including several SEC roundtable participants, have recently called for development of a detailed plan and timetable for the US to move to the adoption of IFRSs.<sup>3</sup>

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<sup>3</sup> Some people in the United States have reviewed the AcSB's IFRS implementation plan and found it to be of sufficient quality that it can provide a model for a possible US plan.

Many people in Europe are concerned that IFRSs are unduly influenced by US GAAP and will become “rules-oriented” rather than “principles-based.” Certainly, the US as a significant global capital market has an influence in the development of IFRSs. However, US standards have been changed in several cases to adopt “better” financial reporting treatments in IFRSs. Current global convergence projects seem likely to result in as much change to US GAAP as to IFRSs, if not more in some cases. The IASB and FASB continue to make progress on the projects in their Memorandum of Understanding. Although there is some expected slippage in timing on some topics, there seems to be no cause for concern that convergence will not continue. The convergence programme is a high priority for both the IASB and FASB.

In contrast to the concerns about the influence of US GAAP, some are concerned that the EU might have undue influence on IFRSs as a result of its process for endorsing standards.

Overall, it seems that these concerns reflect a healthy tension between major organizations with an interest in IFRSs. They do not presently suggest any significant cause for concern that IFRSs will be unduly influenced by any one particular body, and the likelihood of this outcome diminishes as more countries adopt IFRSs. Since the SEC has lifted the requirement for foreign companies to reconcile to US GAAP when filing financial statements prepared in accordance with IFRSs as promulgated by the IASB, EU Commissioner McCreevy has expressed his view that IFRSs as adopted in the EU should differ as little as possible from those promulgated by the IASB.

There is considerable support for IFRSs as a single, internationally-accepted basis of accounting. Some people have raised concerns about the quality of IFRSs, including the following:

*Concerns relating to IFRSs*

- Concerns about the variety of versions of IFRSs that will exist if countries modify IFRSs when adopting them in their jurisdiction. This includes concerns about “national flavours” of IFRSs as accountants in individual jurisdictions naturally cling to past practices in that jurisdiction. However, there is some evidence that national flavours are beginning to give way to flavours within industries, but with greater global consistency. The AcSB intends to encourage its constituents to consult internationally and to learn from the experiences of others internationally, rather than clinging to past practices.
- Concerns about a stable and independent future funding base for the IASB. The IASC Foundation Trustees are continuing to work on establishing a more sound, independent and sustainable basis of funding for the IASB. To date, new funding arrangements have been put in place in several countries and there seems no significant present concern regarding a future lack of funding. Linked to these concerns are questions about whether IASB staff resources are sufficient to support the development of global standards. Additional funding would be expected to alleviate this concern; in addition, greater application of IFRSs globally means more people would be qualified to work for the IASB. National standard setters’ resources

are also available to assist. The AcSB thinks that IFRSs are of sufficient high quality today, and increased funding should only lead to a greater ability to improve that quality in the future.

- Concerns about oversight of the IASB standard-setting processes. Some have questioned the oversight of the IASB's standard-setting processes. The IASC Foundation (IASCF) recently announced that it would set up a new monitoring body to give market watchdogs and other stakeholders a say in IASC trustee appointments, funding and budgets. The new IASCF Chair, Gerrit Zalm, expects the new monitoring body to come into effect in 2008. The AcSB thinks that the IASB "due-process" is second to none. Additional oversight should only enhance those processes further.

*Concerns equally applicable to other bodies of standards*

- Concerns that financial reporting in accordance with IFRSs results in more complex financial reports than in accordance with prior standards and is less connected to the operation of the business. This is a common concern from those who have faced the costs of a wholesale change in standards but have yet to see benefits. It also reflects the difficulty some have in accepting change from well-entrenched practices, as well as the increasing complexity of transactions and business arrangements themselves.
- Concerns about the role and extent of fair value accounting. It should be noted, in this regard, that while IFRSs permit greater use of fair value accounting, the extent of fair value accounting required in IFRSs is not significantly greater than in other sets of accounting standards, including current Canadian GAAP.
- Concerns that IFRSs are not designed for all of the traditional uses of accounts, in addition to informing investors and creditors. These uses include computing tax liabilities, compliance with banking covenants and regulatory capital calculations. The AcSB has been explaining, for some time, that general purpose financial statements are not necessarily designed for all of these uses. This point may be better understood in Canada than in some other countries that have adopted IFRSs.

The AcSB thinks that none of these concerns are sufficiently significant to affect its decision to set the changeover date.

It is early days for a full assessment of the benefits of IFRS adoption. For the most part, there has been insufficient time for academics to conduct research and draw any conclusive results. There is some evidence that benefits have been slower than expected to materialize, as comparability in the first year of adoption has been reduced by adherence to past national practices within the bounds of choice permitted by IFRSs. However, there is some evidence that the more companies integrate IFRSs into their daily record-keeping, the greater the advantage enjoyed.<sup>4</sup> For example, a July 2007 PricewaterhouseCoopers survey notes, "On some issues many UK finance executives are

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<sup>4</sup> Thanks are due to Professor Roger Hussey and MBA students at the Odette School of Business, University of Windsor, for their assistance in reviewing academic literature and studies relevant to the adoption of IFRSs.

ambivalent about the benefits. ... But some definite benefits are noted. These include improved consistency and comparability of companies across Europe and uniform accounting within groups.”

The AcSB notes that IFRSs are already being used in most of the major capital markets. IFRSs have been the subject of evaluation by the International Organization of Securities Commissions, including the SEC. The consensus is that the standards are comprehensive, robust and capable of consistent interpretation and application. IFRSs are extensive in their coverage of accounting issues and continue to grow and evolve. The balance of informed opinion throughout the world, including many people in the US, is that IFRSs strike an appropriate balance between fundamental principles coupled with sufficient implementation guidance to produce high quality, transparent and consistent reporting in a way that serves investors needs. The result of IFRS adoption on other countries has been greater transparency and no discernible disruption of the capital markets. Overall, the AcSB thinks that there is no concern about the quality of IFRSs that should affect the changeover date.